RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Dec. 30, 1987 **LETTER 981**

Dec. 18 DJIA 1975.30; PTI 2618; A-D Ratio -12.20
Dec. 24 DJIA 1999.67; PTI 2620; A-D Ratio -11.70
Current Dow Yield: 3.46%; Dow P/E: 15.8

INVESTING: Last week I gave a lot of thought to the following question: "How can I get across to my subscribers the concept of handling their money correctly and intelligently while a deceptive and (probably) long-lived bear market is in force?"

This is the thought that came to mind: Let's say that you are miraculously given a life span of 200 years. In other words, time will not be a factor in your investing. You've got 200 years to get it right, and you don't have to "beat the market" every month or even every six months.

All right Mr. 200, what do we see? We see a bull market that topped out last August with stock yields at roughly their lowest and least atttractive levels in history. Next, a bear market sets in, an historic crash takes place, and following the crash the market corrects to the upside. What's our position, and what is our investment strategy?

Here's how I, as a 200-years-to-go Dow Theorist, am thinking. "The bull market is over, and the bear has been doing his thing -- taking US investors for a trillion-dollar shearing -- then rallying as the bear tries to get the bloodied sheep back into the fold again.

"Time means nothing to me, and investing correctly means everything. The odds heavily favor this bear market acting like all other bear markets, and that means that ultimately stocks are going back to a level where they will be undervalued again. In other words, before this bear market is over, I'll be looking at blue-chip stocks with average yields of an attractive 6% or more along with all kinds of secondary stocks selling at a mere fraction of their old bull market highs.

"So what do I do? I stay on the sidelines. I avoid all the nonsense I read ("It's a new bull market") in the newspapers, magazines, advisories and in brokerage house handouts. I hold my assets in T-bills or money-market funds and gold plus maybe some very high-grade bonds, and I practice patience. I'm patient because I know that in two, three or four years this bear market will be sinking into a major bottom, a bottom that will provide me with probably some of the greatest bargains of a lifetime. But in order to buy those bargains, (1) I have to believe in the Dow Theory and the primary bear market thesis, (2) I must avoid the pitfall of trying to "beat the bear market" via in-and-out trading or premature buying, (3) I must have liquidity and cash at the bottom so that I will be able to buy those bargains when they finally appear."

In view of all this, why did I say that we should view the current bear market from the standpoint of an investor who will live another 200 years? I put it that way because if you know you're going to live 200 years **you can be very, very patient.**

But here's the secret ingredient. In order to invest correctly, you and I should act just the same as if we are going to live 200 years. *The operative fact is that the market couldn't care less how long we live.* Investing intelligently demands that we adhere to time-tested, correct procedures -- and how many years we are fated to live has nothing to do with it. Patience, intelligence, and control of our emotions has everything to do with it.

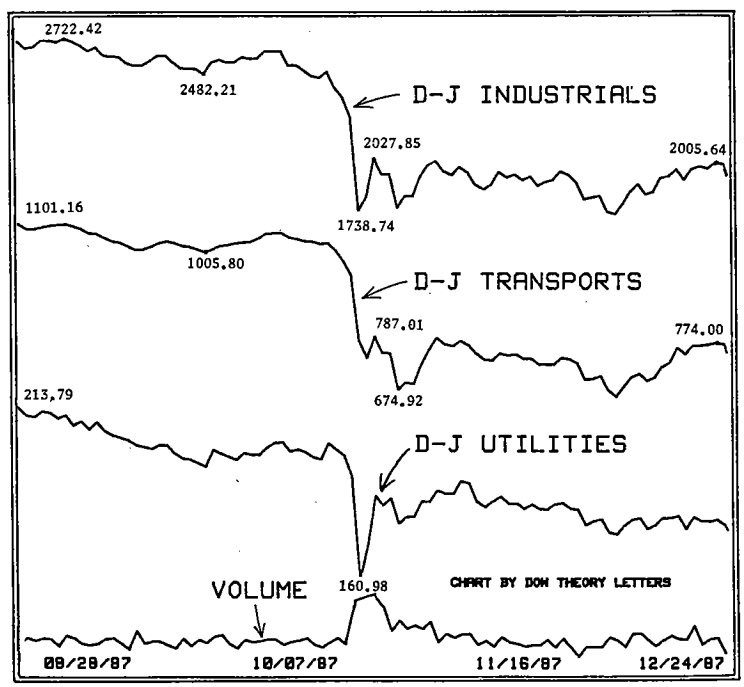
As this is written, the Industrials and Transports are within shooting distance of their Oct. 21 highs. It's impossible in this early section of the Letter to provide a clear analysis of the near-term outlook. Therefore, I will present the **PRICE ACTION** portion of this Letter on page 6 under **LATE NOTES.**

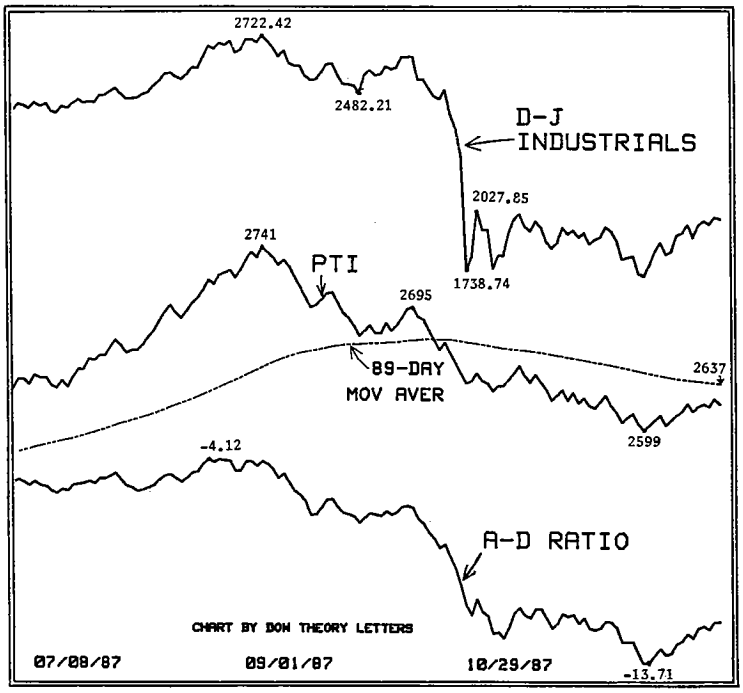
THE PICTURE: What did the bear signal of October 15 and the crash of October 19 really mean? Not an awful lot, if we are to believe most of the current newspaper, magazine, and brokerage house output. But this "information" is being generated by the popular gurus, the same people who failed to see the bear market coming -- the same people who were repeating the fiction that it was only a matter of time before the Dow would roar over the 3000 level.

Here's what I think the bear market and crash really mean. First of all, the crash represented the *most violent and dramatic change in perceptions in the history of Wall Street.* You have to remember (and I have documented this over and over again, although nobody else seems to have picked it up) that the October bear signal and crash did not come out of the blue.

Hardly, the bear market and crash were the result of nine solid months of distribution in the market starting with the January top-out of the Utilities, and progressing to the March downturn in the advance-decline ratio and the August 11 top-out of the Transportation Average (all the while the Financial Index was lagging badly). Finally, the last hero, the D-J Industrial Average, hit its all-alone high on August 25, and that was it -- by late-August a major and historic top had formed.

So right off the bat we can say that the people who are still claiming that "the crash was just an aberration, a computer-generated mistake," these people don't know now, and never did know, what was happening.





As to the meaning of the bear market and the crash, here's the way I see it. After a frothy surge to all-time highs in the various averages, after record highs in over-valuation and after seldom-seen excesses in speculation -- **perceptions changed.** Actually, I believe perceptions among informed investors changed early in 1987, but despite that the market continued to roar to new highs.

By August the Dow had climbed far above "known value," far above what informed investors believed it was actually worth in light of coming events (by mid-August, the Dow had soared 20% above its 200-day moving average). Then came the Dow Theory bear signal and the October 19 crash. The crash, in my opinion, was the market's (violent) way of correcting for the historic extremes in overvaluation. It was the market's way of saying, "We're wrong -- boy are we ever wrong. The picture ahead has ceased to be bullish and here we are with the Dow 1000 points above where it should be. So let me out of here!"

Why do I say that perceptions changed? Why do I say that a bear market was due? After all, aren't the economic statistics still pretty good? Isn't US factory capacity pushing up to new highs for 1987? Aren't retail sales fairly good and aren't housing starts actually up? And the answer is "Yes, the statistics, so far, are pretty good, but in my opinion the stock market is looking in another direction and at other problems." Here is "the other picture" that I believe the stock market is looking at. And remember, **this is not a scenario for next month, this is a long-term picture.**

First, this nation can't continue to run deficits of $140 to $200 billion a year. The sinking US dollar has been telling us that. The sinking dollar has been telling the world's central banks and the world's investors that. To an increasing extent, the US will have to finance its deficits from domestic savings or from its ability to produce (in other words, from corporate profits).

But wait a minute. As far as savings are concerned, they don't exist -- they aren't there. The sad fact is that Americans just haven't been saving. All right, what about productive ability? Here again, we Americans haven't been able to sell foreigners more than foreigners sell us. Furthermore, America has, during the 1980s, actually reduced its factory capacity.

All this means that if we want to turn our trade balance around we're going to have to (1) increase factory capacity, (2) make better products -- cost-competive, well-made products that will sell overseas, and (3) cut domestic consumption drastically.

The figure being talked about if the US is to compete successfully on the international front is a 15% to 20% increase in our productive capacity. Now maybe we can do it, but historically, no developed nation has ever done that before. If we attempt such a dramatic increase in production capacity it will surely run interest rates up much higher. It will also bring on new inflationary pressures. And there's another question. The question is -- if capacity is to expand dramatically, where will the money come from? The answer is that the money must come from the consumer's side of the economy.

What it all boils down to is this. For years this nation has consumed more that it has produced. This is the fundamental behind the compounding trade deficits. The bear market, the crash, and the declining dollar are saying that the party has come to an end. From here on America must start producing more than it spends (as Japan has been doing for years).

Can we do it? Can we make the necessary sacrifices? We'll have to, or we'll end up as a third-rate nation with a slumping standard of living. Why a slumping standard of living? Because foreign nations will refuse to lend us money. We'll then be forced to live within our means, and that will mean (1) higher taxes, (2) lower imports and greatly reduced consumption, (3) vastly reduced government services in such areas as Medicare, Veterans services, Social Security, and (4) rising unemployment.

So that's the picture as I see it and as I believe informed investors see it. I think it is the long-term picture as the market sees it. And it's the scenario which, in my opinion, has set off a major bear market.

Question: Russell, do you mean that all the statistics I've been reading in the newspapers -- the housing starts, the retail sales, the auto sales, the factory capacity -- do you mean to tell me that all those statistics are worthless?

Answer: I'm not saying they're worthless, I'm saying that if you follow them and think they're telling you the real story, you're looking in the wrong direction. The bear is looking far beyond those statistics and far beyond today's OK business.

The real story of what's behind the A-D ratio top-out, the bear market, the October crash, is the story that I outlined above. What I talked about above has to do with the primary trend, the tidal flow of the stock market, not the secondary trend or the daily trend.

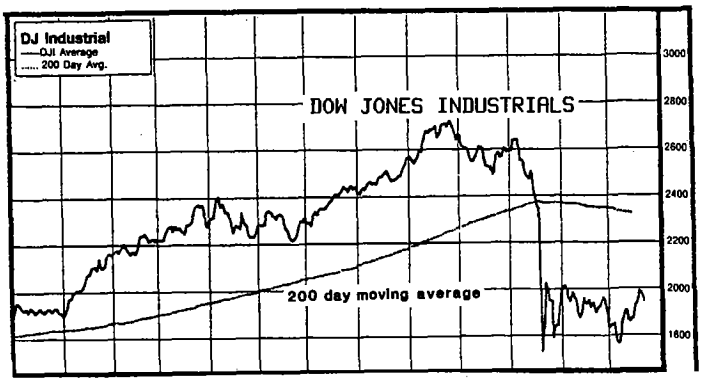
Question: OK, Russell, but what about the market rally since the crash lows? What do you think that is all about?

Answer: I don't know (nor does anyone else) whether the action since October 19 represents part of a coming full correction of all the losses since the August high -- or whether the action since October 19 is simply the bear market working off the historic oversold condition brought on by the biggest crash in history.

If the Dow can better its October 21 high of 2027.85 confirmed with a Transport bettering of 787.01, the odds favor a full correction of the bear market losses so far. Conversely, if one or both Averages fail to better those points, then we'll know that the market was simply rallying within a trading range and working off an oversold situation.

MOVING AVERAGE: One of the commonest tools of the technician is the moving average (MA). I learned the basics of using moving averages years ago from George Schaefer, the great Dow Theorist who died in 1974. George incorporated the 200-day moving average of the Dow into his pioneering Dow Theory studies, and his discussions of MAs were the most enlightening that I have ever seen.

The 200-day MA of the Dow is simply the sum of the last 200 Dow closings divided by 200. Each day the new figure is added to the



total and the 201st day's figure is dropped. This gives us the 200-day moving average.

Schaefer noted that the blue-chip Dow stocks are the type of stocks that are bought by "informed investors." He believed that informed investors set the trend of the blue-chips and it is the blue-chips that set the trend for the rest of the market. Thus, Schaefer noted, if one wants to know the major trend of the market, it is vital to know what informed investors are doing.

Schaefer wrote that the 200-day MA represents "the average price informed investors are willing to pay for the Dow over the past 200 days (or approximately the last 6.6 months)." In fact, Schaefer usually referred to the 200-day MA of the Dow as "the Investment Line."

Schaefer also noted that when the Dow was above the 200-day MA it meant informed investors were optimistic in that they were then paying more for the Dow on average than they had been willing to over the past six months. Conversely, when the Dow was below the 200-day MA it meant that informed investors were pessimistic in that they were then willing to pay less for the 30 Dow stocks than they were willing to pay on average over the last 6.6 months.

Schaefer observed that during bull markets the Dow tended to stay above its rising moving average for long stretches of time. It was only during severe reactions in the bull market that the Dow would dive temporarily below the MA, but once the market was sold-out the Dow would quickly push above the MA again.

During bear markets the Dow would tend to stay below the MA for long periods of time. But again the Dow might rise temporarily above the MA during explosive upward corrections.

The accompanying chart (courtesy of Media General Financial Weekly) shows the Dow and its 200-day MA over the past year. Note that during the height of the bull market frenzy (during March and again during August) the Dow rose approximately 20% above its moving average.

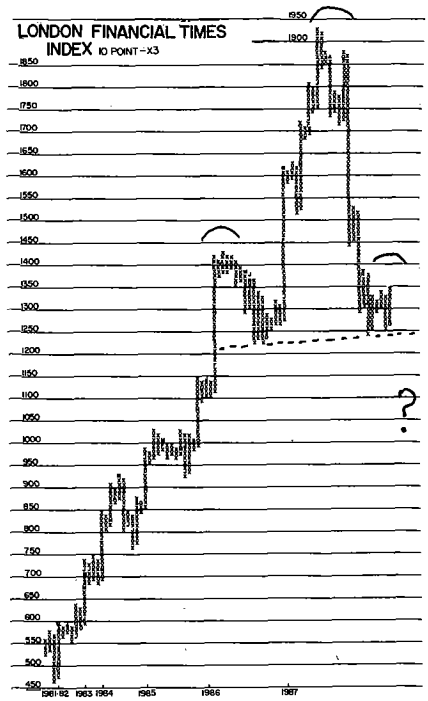
When the crash came, the 200-day MA was around 2375. By the close of the crash day (Oct. 19) the Dow was an unbelievable 26% below its MA (we may never see that again). A week or so later the 200-day turned down, and it has been declining ever since. At present the MA is at about 2330, and we might again refer to this as the investment line.

It is entirely possible that the MA will continue to decline for the duration of this bear market, although I would allow for a few powerful upside corrections to take the Dow temporarily above the MA.

The position of the 200-day MA at any given time provides us with a good "value benchmark" for the bear market. For instance, I obviously can't tell exactly when (nor can anyone else), but somewhere along the line we are going to get a big, violent rally, a rally that will correct the massive downside compression of the crash. When this rally fully expresses itself, it is entirely possible that it will take the Dow within shooting distance of the 200-day MA (which is now dropping at the rate of 1.5 points a day).

So the 200-day MA will serve both as a benchmark and as a level of resistance. Strangely, almost mysteriously, the 200-day MA tends to offer massive resistance on the upside during bear market rallies and it also offers powerful resistance on the downside during bull market corrections.

NOTE: As I've mentioned many times before, primary movements in the stock markets are always international in scope. For this reason, I want to direct attention here to the British market (see page 6 for the Japanese market). This chart of the London FT Index (courtesy of *Market Charts,* 20 Exchange Pl., NYC 10005) outlines a huge and ominous "head-and-shoulders" top pattern with the critical support at about 1200. I don't like the looks of it, and I would not want to see FT Index drop below the 1200 level. (It closed the week of Dec. 24 at 1432.30.)

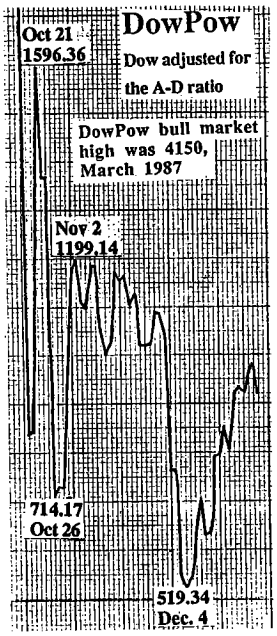


INVESTMENT POSITION: The bear rules the box, as he has ever since the primary bear market signal of October 15. I guess I've already described our investment position earlier in this Letter, so there's no sense repeating it again.

We're on the sidelines as far as equities are concerned. From here on we have to control two basic human emotions -- impatience and greed. And they're closely connected. Treat the bear market as a golden opportunity to deal with these two emotions. Every successful investor I've ever met has learned to master them.

DOWPOW: This is a picture of DowPow (short for "Dow power") which is my proprietary indicator of the Dow adjusted for the advance-decline ratio. The longer I work with this index, the better I like it. I believe it is telling the market story better and more accurately than any other indicator.

Following the October 19 crash low DowPow has presented a bearish progression with each rally peak in DowPow ending below the preceding peak and each decline low breaking below the preceding decline low. If this kind of action continues, we're going to see trouble -- in the form of a swooning market. I don't have any other indicator that so clearly shows this series of bearish zig-zag declines. Declining tops and declining bottoms are the essence of a bear move, and until DowPow reverses this action, DowPow is saying "Danger."



LESSONS: The following are lessons and thoughts which occurred to me during the weeks following the crash. Most of these lessons I already knew, but the October-November action certainly refreshed my memory.

(1) One of the most difficult concepts to grasp is that a prominent person who speaks with seemingly total authority -- can at any given time be totally wrong. That realization has saved me a lot of money over the years. Many's the time I've read a statement from some guru who's been right as rain on the market for an extended spell. And I find myself thinking, "Gad what authority, what confidence, what logic. This guy has just got to be right." Then I think,"But what the hell, I don't agree with him, and after 30 years in this business I've seen too many of these brilliant characters be dead wrong." Lesson: Anybody can be dead wrong about the economy and stock market -- the Fed chairman, Boone Pickens, Dr. Henry Kaufman -- absolutely ANYBODY.

Lesson 2: I don't know how many advisory letters I read every week -- maybe three dozen. I was particularly interested in the reports that were issued right after the October crash. I was particularly impressed by those advisors who came out and admitted that they had been wrong. And believe me, there were very FEW of these. Most gave excuses or claimed that the market was "wrong" or "overdoing it" or some other total nonsense.

Honesty is the best policy -- even in the investment advisory business, which is not famous for its forthrightness. The crash made hash of most of the easy and automatic analysis methods. If it's easy, if anybody can follow it or read about it, be careful, it can easily be wrong.

Lesson 3: All the gimmicks in the world aren't worth a damn where the stock market is concerned. The Super Bowl theory, the hemline theory, the January bellwether theory, etc. No, nothing as easy as a gimmick will make you money or make you right in the stock market. Let me put it this way: If it's obvious, if it's automatic, it if requires no thinking, if everybody knows about it -- it's worth absolutely ZERO as far as the market is concerned.

Lesson 4: The five most costly words in Wall Street's vocabulary are, "This time it's different." Why do those words prove so costly every time the stock market nears a major top? Because people actually believe that this time it is different. Many intelligent people told me that with 50% margin (instead of 1929's 10%) the market could not crash. Now they tell us that because of the various government safety nets we can never have another depression. I sure hope they're right about the depression (and to be honest, I sometimes find myself believing that malarcky myself). But then I get back to reality, and I realize that the people running our government today are just as stupid and cowardly as the guys who ran the government in 1929. Besides, as I've said many times before, economists and the politicians are always looking in the wrong direction when the trouble hits.

Lesson 5: This is a principle that is so simple it is naive; nevertheless, many people have never learned it. You can be 100% or 50% or 10% invested in stocks in a bull market and it's not going to make or break you, since in the course of a bull market almost all stocks go up, and it's simply a case of how big a position you want to take and how much faith you have in the bull market.

Not so in a bear market. You're going to lose money in a bear market, and the more stocks you own and the larger your position, the MORE money you're going to lose. So the correct position in a bear market is ZERO percentage in stocks. In other words, there's a big difference between not making as much as you could during a bull market, and losing your shirt during a bear market.

Lesson 6: There's nothing in economics as dramatic as a bear signal in the stock market -- except a bear signal and an ensuing stock market crash. Following the October 19 crash, the phone around here never stopped ringing --newspapers were calling, we've had reporters at our home doing interviews, we had people phoning in at 6AM in the morning and at midnight; it was pandemonium. My wife, Faye, is philosophical. She told me, "That's the business you're in. If you want privacy, go write a novel."

Back in 1974 when I announced a Dow Theory bull signal it really was fairly quiet. Most people were out of the stock market, the newspapers didn't believe the bull signal anyway, and the drama wasn't there (until early 1985 when the market finally exploded on the upside).

FATE : Every few months some guy will come up to me and say, "Russell, you've really got a sweet racket. You hang out here in La Jolla, turn out a report every two weeks, and the rest of the time you can sit by the ocean and watch the palm trees swaying."

And I have an answer ready. The answer goes like this, "You know, Gus, I don't know why you don't cut yourself in on this racket, yourself. Heck, it's the easiest thing in the world to get into -- anyone can do it. All you need is a pencil and paper, some postage stamps, a few ads in *Barron's* or *Investor's Daily*, and you're on your way. I can't imagine why you don't try it."

That usually ends the conversation. The fact is that this is one tough business. Of the thousands of market analysts, maybe 100 write non-brokerage market reports. Of those, maybe 10 of us make a good living out of it. The "now you see him, now you don't" rate in the advisory publishing industry is probably as bad as it is in the restaurant business. In the advisory business the motto is "Here today and gone tomorrow."

When I think about it, only three or four of the old-timers (people who were around during the late-1950s or early 1960s) are still publishing today. They come, they struggle, they get chewed up by the market, and they depart. I often wish that I had kept a record of friends of mine in this industry and what happened to them and why, and how the market (in most cases) finally did them in.

Why am I waxing philosophical? Because next year, 1988, will mark the 30th year that I've been writing Dow Theory Letters. I never, back in 1958, thought in my wildest dreams that I'd be writing these reports for 30 years. For one thing, I thought I'd retire at age 60. For another, I thought I'd burn out after 15 or 20 years. Obviously, neither event occurred.

Strangely, I found out that I didn't want to retire -- ever. And secondly, I discovered that if I did my best, if I applied myself, if I didn't promise my subscribers more than I had any right to deliver -- that my business would flourish. And it has. Wall Street owes me nothing. The fact is that I have always made a handsome living with Dow Theory Letters. The Letters allowed me to raise five kids, they allowed me to survive and live the way I wanted to through two divorces, they allowed me to build up enough capital and savings so that I feel secure today.

So the fact is that to me, Dow Theory Letters is a labor of love. I've been accused by people who know me of being a workaholic. But to me, work is doing something tedious, something you don't really like to do. As far as the stock market is concerned, I don't consider it work. And I guess that's the ideal situation -- making a living doing something you love.

I don't know why the markets fascinate me. It probably has to do with my desire to know the unknowable, to fathom the

unfathomable, to uncover the secret of my fate -- even though I know that it's utterly impossible. How do I know it's impossible? I know from experience. As I young man I charted out the exact course I wanted my life to take. Nothing, literally nothing, that I had planned came to pass (and that is not a complaint, only a good-natured observation). In view of that, I often ponder this passage from Ecclesiastes 7:13, a passage which, by the way, has helped me considerably in my attitude toward life:

"Consider the work of God. Who can set straight what he has made crooked? When times are prosperous enjoy your happiness. When times are bad consider this: The one is God's doing as is the other -- in order that man may know nothing of his destiny."

NOTES & QUOTES: Here's a happy thought as we kiss 1987 goodbye. Your share of the national debt was $34,737 in 1987. In the past 12 months your share increased by $4,233. Your share of the interest on the federal debt in 1987 was $2,174.

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My friend, Charlie Maxwell of C.J. Lawrence, is widely considered to be the best oil analyst in the nation. He was predicting $15 oil months before it happened. In his Dec. 15 report Charlie writes: "On our calculations, 18.5 million barrels per day is too high to support the oil priced at anything near $18 per barrel. We hold the OPEC must produce no more that 16.5 to 17 million barrels per days, if supply is to meet demand at the $18 level. Therefore, we assume an impending price drop to below $15 per barrel, possibly as low as $12 per barrel over the next several months." Russell note: That is deflationary, very. And it's a killer for the oil-producing states like Texas, Oklahoma, Louisiana -- and their banks.

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According to the *Economist*, "By 1990 America's three big carmakers -- GM, Ford and Chrysler -- will be making 1.6 million fewer cars than they did last year. Japanese factories in America will be making 800,000 more at 1.3 million, which together with imports from Japan could account for around 40% of the N. American market. On the Japanese companies' own optimistic projections, the Japanese could be making more than 2 million cars a year at the end of the decade. By then their American plants will be, in effect, the third biggest carmaker in America, having overtaken Chrysler. They may eventually force one of the present top three off the track altogether."

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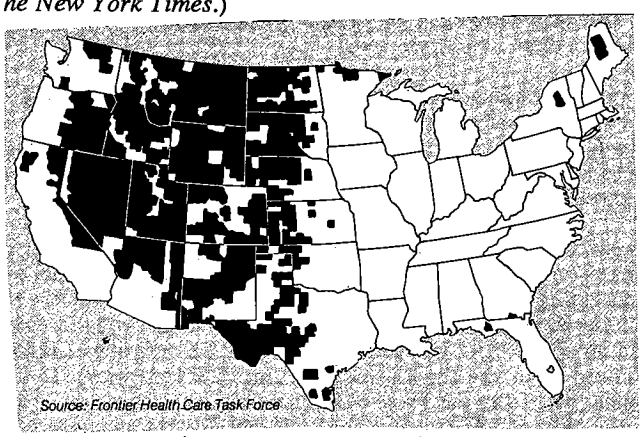
Is America running out of space? Are you dreaming of elbow room? There's still plenty of space left in the US. The latest census shows that there are 394 counties (including all of Alaska) covering 45% of the land area of the US with six or fewer people per square mile (only 2.2 million people live in 45% of the US land mass). The black areas on this chart (Alaska not shown) identify the counties with 6 or fewer people per square mile.(Chart courtesy of *The New York Times*.)



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The world is war-mad. A new study shows that whereas world economic output from 1960 to 1987 has grown 62%, inflation-adjusted military outlays are up 146%. Military spending from 1960 to 1985 totaled $13.8 trillion, while the world's economic products totaled only $8.6 trillion. The US military budget in recent years exceeded total public spending on health by 57% and on education by 28%. Russia spends twice as much on its military as on health and education combined. A rough estimate is that over 500,000 scientists (mostly in the US and Russia) are employed in military research and development.

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What's up over the last six months (not much) and what's down? Up is gold, +9.7%; silver, +1.3%; CRB Commodity Futures, +3.3%; intermediate-term bonds, +2.5%. **Down** is the Dow, -18.6%; Transports, -25.3%; Utilities, -14.4%; S&P 500, -19.4%; Amex, -24.3%; Value Line, -25.4%; Wilshire 5000, -20.3%.

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Outlandish prices are still the order of the day at the auction houses. A few weeks ago a Christie's auction in England brought out the following prices: $151,000 for a Charlie Chaplin hat-and-cane set, $70,840 for a set of Chaplin scruffy laced black boots, a Gershwin manuscript for $121,000, a Frank Lloyd Wright table lamp for $132,000.

* *

A week ago 33 top economists from 13 nations assembled in Washington for a meeting of the Institute for International Economics. The conclusion of the economists was that the world was suffering from many diseases of imbalance. The cure, they said, "must begin in the US, whose twin deficits lie at the heart of the matter. ... To restore balance, it will require the elimination of the present US current-account deficit (more than $150 billion) and offsetting the costs of the US becoming the world's largest debtor (annual US service charge -- $50 billion a year). "

On the other hand, Japan, Germany, and other countries will have to see their external surpluses shrink by $150 to $200 billion a year. The crucial step, said the economists, is to have the US cut its budget deficit by $40 billion a year over each of the next four years. *(Russell comment: do these cures sound evenly remotely feasible to you?)*

The study noted that two financial shocks have already occurred. The first was the 30% drop in the bond market in 1987. The second was the 30% drop in the stock market also in 1987. If drastic steps are not taken, the study is looking for "a third crash of the markets that could be greater than either predecessor -- with far more pervasive results."

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From James Reston's (former head of the NY Times Washington Bureau) recent column: "The only possible explanation of the Democrat's campaign for the Presidency is that it's being run by the Republicans. They've made every mistake in the book except bringing back Senator Kennedy. Their best men won't run and their worst won't quit. It would be funny if it weren't so serious.

... Gary Hart is making a laughing stock of his party. He treats it the way he treat his wife: as a personal convenience. ... The reappearance of Gary Hart on the scene, however has been helpful in only one respect. He has created such a mess in his party that it will either have to wake up or give up for another four years."

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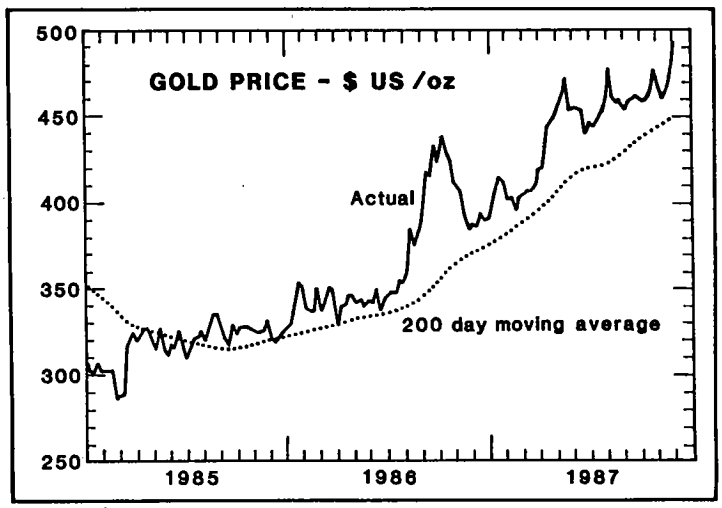
Britain's *Economist* magazine states that "six is company, seven is a farce." Then they include this cartoon of Mr. Hart. One picture is worth ... .

* *

Contrary Opinion, anyone? *Blue Chip Economic Indicators* monitors dozens of top economists on their views. As to 1988, of 40 economic views listed in the Dec. 20 NY Times, all but four (90%) saw the GNP on the plus side for 1988 with the average forecast betting on a 2% rise in GNP. Of 42 economists reviewed by *Business Week* (Dec. 28), only three were predicting that all four quarters of 1988 would show negative GNP figures Thus

the great contrary opinion for 1988 would be four quarters of minus GNP results (i.e., in other words, only three of 42 economists are looking for a year-long recession in 1988).

GOLD: If you're trying to make a living trading gold, you're probably pulling your hair out -- mainly because there's been very little volatility in the metal -- and if there's one thing a trader needs it's volatility (i.e., action). But if you've followed my advice and been accumulating gold on a monthly dollar averaging basis, you have very little to complain about (and you didn't need any volatility).



This chart shows you why. Just let your eye follow the 200-day moving average, and it's obvious that the long-term path of gold has been UP. As of now the 200-day MA is at 450 and climbing. So my advice on gold (the same advice I've been giving all through 1985 and '86) is -- "Keep buying gold bullion coins. Buy what you can afford, and do it every month. When your bank vault gets too heavy to lift, sign up for another vault. But keep buying."

We're getting steadily closer to the point where the US debts and deficits are going be progressively more difficult and burdensome to handle. At some point foreigners will get a bit (actually VERY) queasy. When that happens, foreigners may do more than just halt their buying of US debt -- they may want to get OUT of dollar denominated items, including our debt. That, I believe, is when we will see the beginning of the REAL MOVE into gold. The move will be set off by investors who have ceased to believe in paper currencies, and who don't trust governments.

Our politicians obviously want to keep the party going while avoiding the pain of the big after-party hangover. So the politicians have opted to let the dollar collapse, but at the same time they have avoided cutting the budget or the deficits.

This policy, in my opinion, will ultimately prove disastrous. Washington has sacrificed the dollar for nothing. They have let the dollar go down the drain (without taking the required budgetary measures), and in so doing, they have used up their ammunition without winning the battle.

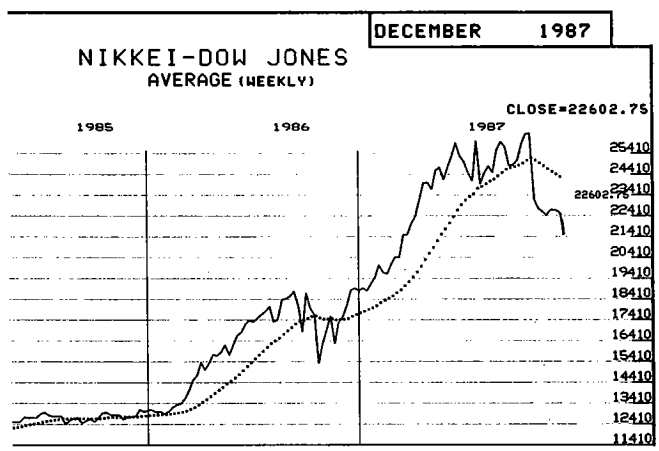
In past Letters I listed my selections as the most disastrous US blunders since the nation was founded. The first was the policy (beginning in the 1940s) of opting for deficit-spending year after year. The second was the Vietnam War (which cost us thousands of lives and almost bankrupted the nation in a stupid and immoral war). To these I now add a third -- the policy of allowing the destruction of the US currency (without taking the necessary steps to eliminate the budget deficits).

Final thought: Gold is pushing up as the dollar weakens, but I can hardly say that the yellow metal is acting spectac ularly. My feeling here is that gold is seeing the same thing that the bonds are seeing -- recession and deflation in 1988-89 (and gold seems to be reacting more to that scenario than to the weakening dollar).

LATE NOTES: As subscribers know, my choices for investments in this bear market have been T-bills, gold bullion coins, and high-grade bonds (muni bonds in my own case). Since the Oct. 19 crash lows, the **T-bonds** have climbed roughly 13 points or about 17%, with the **muni bonds** doing about as well. But whether bonds can hold together in the face of what's happening to the dollar is anyone's guess. So far, however, I'd have to say that bonds are acting well in the face of adverse conditions. It's almost as if the bonds are more tuned in to an impending 1989-90 recession (and deflation) than they are to the weak dollar.

To me, the picture is clear enough. The US continues to spend its head off, the President and Congress have done absolutely NOTHING to right the situation, and the rest of the world KNOWS IT. Therefore, our creditors are protecting themselves in the only way they know how -- they're selling dollars. Reagan ("I'll sign anything") and the Congress have been fiddling while the currency of the US burns.

In the meantime, I am watching the **Japanese stock market** (which nobody else seems to be doing), and I definitely don't like what I see (chart courtesy of Mansfield). A drop by the Nikkei below 21,000 would represent a further serious breakdown, a breakdown which would come from below the long-term moving average. Such a crack would be highly bearish and would confirm (in my humble opinion) a bear market in Japan. If that occurs, I believe it would represent a major negative for the US markets.



As to the **US stock market**, the Averages closed the week ending December 24 with both the D-J Industrials and Transports within shooting distance of their post-crash (i.e., Oct. 21) rebound highs of 2027.85 (Industrials) and 787.01 (Transports). On a few days the Dow even pushed above 2,000, and many traders undoubtedly took this as a signal to rush headlong back into stocks. The bear welcomed them with open paws.

The post-Christmas week (Dec. 28) began with heavy selling of stocks, based partly on a further wide-open break in the dollar. As this is written, the PTI is 22 points below its moving average (i.e., still in a bearish mode) and DowPow is displaying continuing weakness (see DowPow discussion on page 4).

The painfully weak dollar is rendering Japanese and European goods very expensive for Americans. Obviously foreign markets are reflecting this. At this point I would not rule out a crash in the Japanese markets. A Japanese market crash would probably bring about an abrupt halt to Japanese buying of US securities (in fact, we could even see the Japanese selling US securities). If that happens, we'll see the Free World heading into recession -- and rapidly. Forget US housing starts, forget Bloomingdale's sales figures, the critical focus is now on Japan and the world markets (the German market is already kaput). As I see it, the picture from overseas is not a pretty one.

NEXT MAILING: Jan. 13, 1988